



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

HEAD OFFICE

March 21, 2022

(Submitted Electronically)

International Accounting Standards Board
London, United Kingdom

Comments on Exposure Draft 2021/9 - *Non-current Liabilities with Covenants*

Dear Board Members,

The Institute of Chartered Accountants of Pakistan is pleased to comment on the Exposure Draft (ED) '*Non-current Liabilities with Covenants*' issued by the International Accounting Standards Board (the Board/ IASB) in November 2021.

We support the Board's initiative and efforts for undertaking a project of narrow-scope amendments to IAS 1, to address stakeholders' concerns about the classification of liabilities as current or non-current (2020 Amendments to IAS 1) and the IFRS Interpretations Committee tentative agenda decision. However, we have concerns and comments on the extent of proposed disclosures, classification, and separate presentation of liabilities classified as non-current for which the entity's right to defer settlement for at least twelve months after the reporting period is subject to compliance with specified conditions within twelve months after the reporting period.

The Appendix to this letter contains our detailed comments and responses to the questions in the ED.

We hope our comments are helpful to the Board's deliberation on the ED. Should you require further clarification on our comments, please contact the undersigned, at sohail.malik@icap.org.pk

Yours truly,

Sohail Malik
Director Technical

Encl. As above

**ICAP comments on the specific questions of
Exposure Draft 2021/9 – Non-current Liabilities with Covenants**

Question 1—Classification and disclosure (paragraphs 72B and 76ZA(b))

The Board proposes to require that, for the purposes of applying paragraph 69(d) of IAS 1, specified conditions with which an entity must comply within twelve months after the reporting period have no effect on whether an entity has, at the end of the reporting period, a right to defer settlement of a liability for at least twelve months after the reporting period. Such conditions would therefore have no effect on the classification of a liability as current or non-current. Instead, when an entity classifies a liability subject to such conditions as non-current, it would be required to disclose information in the notes that enables users of financial statements to assess the risk that the liability could become repayable within twelve months, including:

- (a) the conditions (including, for example, their nature and the date on which the entity must comply with them);
- (b) whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period; and
- (c) whether and how the entity expects to comply with the conditions after the end of the reporting period.

Paragraphs BC15–BC17 and BC23–BC26 of the Basis for Conclusions explain the Board’s rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Comments

We agree with the Board’s views that only those specified conditions with which an entity must comply on or before the reporting date affect the classification of a liability as current or non-current. While conditions with which an entity has to comply after the reporting date do not affect the classification of liability at the reporting date.

However, we have concerns about the extent of disclosures required in paragraph 76ZA(b). The proposed disclosures of paragraphs 76ZA(b)(i) and 76ZA(b)(ii), require information about the conditions with which the entity is required to comply and whether the entity has complied at the year-end with those conditions, are too extensive. In many cases, these extensive disclosures may not provide any useful information to the users of financial statements. Further, such detailed disclosure would involve practical challenges for entities as this information may not be readily available and the cost of preparing proposed disclosures might outweigh the benefits.

We also disagree with the proposed disclosure stated in paragraph 76ZA(b)(iii) of the ED, requiring entities to provide information that whether and how the entity expects to comply with the conditions after the end of the reporting period. Such disclosure would involve forward-looking information, which besides management judgments and preparation costs can also pose auditing challenges. On this proposed disclosure we agree with the alternative views expressed by the Board members (Mr. Mackenzie and Mr. Scott) as stated in paragraph AV5 of ED.

We suggest that a principle-based approach is followed, outlining the requirement to disclose those covenants only which are at high risk of breach and could materially impact the financial statements.

We also note that IFRS 7 has set out disclosures of liquidity risk. Entities are required to disclose a maturity analysis for financial liabilities (showing the remaining contractual maturities). IFRS 7 disclosure can be enhanced to cover the disclosure of information about the risks of earlier cash outflows owing to a possible breach of debt covenants after the reporting date. This information would enable users of financial statements to evaluate the nature and extent of liquidity risk arising from the probable breach of debt covenants.

Question 2—Presentation (paragraph 76ZA(a))
<p>The Board proposes to require an entity to present separately, in its statement of financial position, liabilities classified as non-current for which the entity's right to defer settlement for at least twelve months after the reporting period is subject to compliance with specified conditions within twelve months after the reporting period.</p> <p>Paragraphs BC21–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.</p> <p>Do you agree with this proposal? Why or why not? If you disagree with the proposal, do you agree with either alternative considered by the Board (see paragraph BC22)? Please explain what you suggest instead and why.</p>

Comments

Paragraph 76ZA(a) of ED proposes the separate presentation (in the statement of financial position) of liabilities classified as non-current for which the entity's right to defer settlement for at least twelve months after the reporting period is subject to compliance with specified conditions within twelve months after the reporting period.

We do not support the requirement of paragraph 76ZA(a). We agree with the alternative view as mentioned in paragraph BC22(a) of ED. The alternative view does not require a separate presentation of those liabilities in the statement of financial position. In this context, we support the views of Board members discussed in paragraphs AV3 and AV4 of ED.

Users of financial statements might construe the separate presentation as a matter of concern when in fact they might not be. It would be difficult for preparers of financial statements to comply with the proposed approach of mandating such presentation.

The principle-based approach of providing relevant and useful disclosures and information in consideration of specific needs of entity's financial statements users is the preferred approach.

Question 3—Other aspects of the proposals

The Board proposes to:

- (a) clarify circumstances in which an entity does not have a right to defer settlement of a liability for at least twelve months after the reporting period for the purposes of applying paragraph 69(d) of IAS 1 (paragraph 72C);
- (b) require an entity to apply the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, with earlier application permitted (paragraph 139V); and
- (c) defer the effective date of the amendments to IAS 1, Classification of Liabilities as Current or Non-current, to annual reporting periods beginning on or after a date to be decided after exposure, but no earlier than 1 January 2024 (paragraph 139U).

Paragraphs BC18–BC20 and BC30–BC32 of the Basis for Conclusions explain the Board's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Comments

Comments on classification of circumstances in which an entity does not have a right to defer settlement

We support the Board's initiative of clarifying the circumstances in which an entity does not have a right to defer settlement of the liability for at least twelve months after the reporting period for the purposes of applying paragraph 69(d) of IAS 1.

However, we have concerns about the proposed approach and wording of paragraph 72C. In our view, the application of the proposed paragraph would be subject to interpretation and possibly differing views. It might also result in liabilities being classified as current merely due to the existence of certain covenants.

- a) The proposed wording of paragraph 72C(a) would require the current classification of liability when at the discretion of the counterparty or a third party, liability is payable within twelve months of the reporting date.

In Pakistan, debt arrangements include protective financial covenants (for example, the borrower is required to maintain specified financial ratios). Debt arrangements also state that any non-compliance with any covenant would be an event of default. Under the contractual terms, the lender has to serve a notice to the borrower, prior to exercising its rights in the event of default. In practice, in case of borrower's non-compliance with financial covenants (such as borrower's

inability to maintain a specified ratio), the lender using discretionary power does not serve, and resultantly event of default is not triggered. We believe that the application of proposed paragraph 72C(a) in the above scenario would lead to interpretational issues and risk of divergent views, about;

- entity's (i.e. borrower's) right to defer the settlement of liability; and
- and 'discretion' of the counterparty.

- b) Paragraph 72C(a) uses the phrase 'discretion of the counterparty'. The contractual arrangements are based on the 'rights' and obligations. Paragraph 69(d) and related proposed paragraphs of IAS 1 use and discuss the 'right' of the borrower. We understand that the counterparty's discretion to demand payment would arise only if it has the contractual right to demand such payment. The contractual arrangements are based on the 'rights' and obligations. Paragraph 69(d) and related proposed paragraphs of IAS 1 also use and discuss the term 'right', in the context of the borrower.

In accordance with paragraph 69(d) an entity shall classify liability as current when it does not have a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting date. In other words, a liability should be classified as a current liability when the counterparty, has the unconditional right at the end of the reporting date, to demand payment of the liability within twelve months after the reporting date. We suggest that the Board considers the principle-based approach that is based on the unconditional right of the counterparty, in place of proposed paragraph 72C.

If Board decides to retain paragraph 72C, then in certain cases proposed paragraph 72C(b) could interact with paragraph 75 of IAS 1. Paragraph 75 states that a debt is classified as non-current if the lender agrees by the reporting date to provide a grace period ending at least 12 months after the reporting date. The interaction between proposed paragraph 72C(b) and paragraph 75 of IAS 1 will arise in the scenario where an entity has received a waiver from the lender at end of the reporting period. However, this grace period is ending within twelve months. A discussion and clarification on the possible interaction of these two paragraphs would be helpful.

Comments on transition

We agree with the transition requirement of applying the proposed amendments retrospectively, in accordance with IAS 8.

Comments on deferral of the effective date of the amendments to IAS 1, Classification of Liabilities as Current or Non-current

The amendments to IAS 1, *Classification of Liabilities as Current or Non-current*, issued by the Board in 2020, are effective January 1, 2023. We note that the proposed requirements of the ED would amend some of the requirements introduced by the Board in 2020. In view of this, we agree with the proposed paragraph 139U of the ED, deferring the effective date of the 2020 amendments to IAS 1.